

Company

27 July 2009 | 8 pages

Bank of Baroda (BOB.BO)

 Equity

Hold: 1Q09 Results – High Profits, Modest Quality

- 80%+ profit growth trading/write-back driven** — While BOB's 1QFY10 profits were up 85% YoY, well ahead of our 48% expectation, they did disappoint. The primary drivers of the beat were trading gains (pretty common in the quarter) and equity/offshore portfolio write-back (less common in the quarter). The profit camouflages core P&L pain, whereas a simple reading of the results does not. The BS does feel a bit of strain too, but did a little better than expectations
- Margins and fees hurt** — Margins for the sector have suffered a little ahead of expectations. BOB's are down almost 32bps YoY (48 bps QoQ) and it appears to be among those that have suffered most. Fee incomes have also been relatively wobbly, culminating in pre-provisioning operating profits falling 24% QoQ (up only 7% YoY). This is disappointing, and while management expects a reversal in the rest of the year, it will likely be of modest means relative to the quarters hit.
- Asset quality pinch, but overall in pretty good shape** — There has been an increase in NPL's (incremental deterioration at 1.3% of loans), and restructured loans have also increased by almost 60% (although within levels guided at the beginning of the quarter). We believe there will continue to be a level of pressure for the next 3-4 quarters, but with coverage levels up to 80% and net NPL's at under 0.3%, we believe asset quality will need to be watched but that it is well under check.
- Maintain Hold** — The quarter reflects P&L pain a little ahead of expectations and BS pressures probably a little less than expectations. With management suggesting a relatively cautious outlook, the stock only looking moderately attractive on valuation, and no real big directional upside/downside on P&L or BS, we expect the stock to stay within its current trading range.

Statistical Abstract

Year to	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
31 Mar							
2008A	14,355	39.27	39.9	11.3	1.5	14.6	1.8
2009A	22,273	60.93	55.2	7.3	1.3	18.6	1.9
2010E	23,191	63.44	4.1	7.0	1.1	16.7	2.0
2011E	27,227	74.49	17.4	6.0	0.9	17.0	2.3
2012E	32,966	90.19	21.1	4.9	0.8	17.7	2.3

Source: Powered by dataCentral

See Appendix A-1 for Analyst Certification and important disclosures.

Hold/Medium Risk	2M
Price (27 Jul 09)	Rs444.00
Target price	Rs495.00
Expected share price return	11.5%
Expected dividend yield	2.0%
Expected total return	13.5%
Market Cap	Rs161,734M
	US\$3,363M

Price Performance (RIC: BOB.BO, BB: BOB IN)



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Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	11.3	7.3	7.0	6.0	4.9
P/E reported (x)	11.3	7.3	7.0	6.0	4.9
P/BV (x)	1.5	1.3	1.1	0.9	0.8
P/Adjusted BV diluted (x)	1.7	1.4	1.2	1.0	0.9
Dividend yield (%)	1.8	1.9	2.0	2.3	2.3
Per Share Data (Rs)					
EPS adjusted	39.27	60.93	63.44	74.49	90.19
EPS reported	39.27	60.93	63.44	74.49	90.19
BVPS	302.14	353.51	406.83	470.06	549.00
Tangible BVPS	302.14	353.51	406.83	470.06	549.00
Adjusted BVPS diluted	260.65	312.02	365.34	428.57	507.51
DPS	8.00	8.50	9.00	10.00	10.00
Profit & Loss (RsM)					
Net interest income	39,118	51,253	59,238	71,122	83,735
Fees and commissions	5,402	6,482	7,454	8,349	9,351
Other operating Income	15,109	21,078	18,383	20,046	21,687
Total operating income	59,628	78,813	85,075	99,517	114,773
Total operating expenses	-29,343	-35,760	-40,000	-44,744	-50,052
Oper. profit bef. provisions	30,286	43,053	45,075	54,773	64,721
Bad debt provisions	-4,360	-4,130	-8,462	-12,137	-13,519
Non-operating/exceptionals	-3,854	-5,490	-2,000	-2,000	-2,000
Pre-tax profit	22,072	33,433	34,613	40,637	49,203
Tax	-7,716	-11,160	-11,422	-13,410	-16,237
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	14,355	22,273	23,191	27,227	32,966
Adjusted earnings	14,355	22,273	23,191	27,227	32,966
Growth Rates (%)					
EPS adjusted	39.9	55.2	4.1	17.4	21.1
Oper. profit bef. prov.	15.4	42.2	4.7	21.5	18.2
Balance Sheet (RsM)					
Total assets	1,795,995	2,231,920	2,599,296	3,035,061	3,506,099
Avg interest earning assets	1,561,715	1,958,326	2,358,677	2,761,727	3,217,797
Customer loans	1,086,918	1,463,570	1,728,110	2,073,475	2,438,662
Gross NPLs	19,815	18,430	29,923	43,124	56,829
Liab. & shar. funds	1,795,995	2,231,920	2,599,296	3,035,061	3,506,099
Total customer deposits	1,520,341	1,923,977	2,262,443	2,664,647	3,095,223
Reserve for loan losses	19,905	23,808	31,368	42,436	54,192
Shareholders' equity	110,439	129,216	148,706	171,821	200,674
Profitability/Solvency Ratios (%)					
ROE adjusted	14.6	18.6	16.7	17.0	17.7
Net interest margin	2.50	2.62	2.51	2.58	2.60
Cost/income ratio	49.2	45.4	47.0	45.0	43.6
Cash cost/average assets	1.8	1.8	1.7	1.6	1.5
NPLs/customer loans	1.8	1.3	1.7	2.1	2.3
Reserve for loan losses/NPLs	100.5	129.2	104.8	98.4	95.4
Bad debt prov./avg. cust. loans	0.4	0.3	0.5	0.6	0.6
Loans/deposit ratio	71.5	76.1	76.4	77.8	78.8
Tier 1 capital ratio	7.6	8.5	7.7	7.6	7.7
Total capital ratio	12.9	14.1	11.6	10.9	10.6

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Figure 1. Bank of Baroda: 1Q FY10 Highlights (Rupees Million, Percent)

	1Q10	1Q09	YoY %	4Q09	QoQ%	CIRA Comments
Interest Income	40,321	32,938	22.4	41,388	-2.6	
Interest Expense	-28,274	(22,368)	26.4	(26,680)	6.0	
Net Interest Income	12,047	10,570	14.0	14,708	-18.1	Weak – margins fall relatively sharply – amongst the poorer performers in the system – over 10% lower than expectations
Fee-Based Income	4,476	4,214	6.2	5,526	-19.0	Relatively modest – reflecting in part a lack of loan linked fees in the current quarter
Other Non-Interest Income	2,554	912	180.2	3,010	-15.1	Aggressive fixed income and equity gains – will move with the market, although BOB remains a little more active on the equity side than most peers
Non Interest Income	7,030	5,126	37.2	8,536	-17.6	
Operating Income	19,077	15,696	21.5	23,244	-17.9	
Operating Expenses	(8,978)	(7,694)	16.7	(10,199)	-12.0	
Pre-Provision Profit	10,099	8,002	26.2	13,045	-22.6	
Pre-provision profits (ex-trading gains)	7,545	7,090	6.4	10,035	-24.8	A distinct step down over previous quarter (20% lower than our expectations) – a mix of NII and Fee strains, although the fourth quarter tends to be a seasonal high
Charges for Bad Debts	(3,171)	50	NM	(2,527)	25.5	Expect provisioning charges to sustain at current levels
Other Operating Items	3,561	(2,253)	NM	430	728.0	Significant write-back on equity, and off-shore CLN book – these gains are ahead of peers because of mix, although so was the pain in the previous year
Pre-Tax Profit	10,489	5,799	80.9	10,947	-4.2	
Tax	(3,635)	(2,090)	73.9	(3,421)	6.3	
Net Profit	6,854	3,709	84.8	7,527	-8.9	25% ahead of our near 50% profit jump – trading and revaluation driven, with core operating performance weaker
EPS	18.8	10.2	84.8	20.7	-8.9	
Customer Loans	1,426,720	1,112,140	28.3	1,439,860	-0.9	De-growth over quarter – but elevated growth over previous quarter will likely see YoY growth levels remain higher than industry – in sync with managements' objectives. Slightly exaggerated by currency gains, given expansion of its off-shore portfolio
Customer Deposits	1,986,090	1,549,080	28.2	1,923,970	3.2	Relatively strong, with an improved deposit mix and CASA touching a high of 35% – the overall cost of these deposits though has been high
AIEA	1,981,379	1,534,374	29.1	2,019,417	-1.9	
AIBL	1,955,030	1,427,761	36.9	1,805,065	8.3	
Total Assets	2,393,566	1,772,242	35.1	2,213,963	8.1	
Avg Assets	2,303,765	1,744,998	32.0	2,113,328	9.0	
Non-Performing Loans (NPL)	20,682	20,911	-1.1	18,429	12.2	Deterioration along expected lines – about 1.3% of loans, within which management hopes to remain: Restructured assets to rise to about 2.5% of loans (1.8% in March), although this is within guided levels
Loan Loss Reserves (LLR)	(16,896)	(15,156)	11.5	(13,918)	21.4	
Shareholders' Funds	120,726	98,978	22.0	113,872	6.0	
Book Value Per Share	331	272	22.0	313	6.0	
Key Ratios (%)	1Q10	1Q09	Bps Δ YoY	4Q09	Bps Δ QoQ	
ROAA (annualized)	1.19	0.85	34	1.42	-23	
ROAE (annualized)	22.71	14.99	772	26.44	-373	Profitability is high, but primarily trading and write-back driven
Net Interest Margin (bps)	243	276	-32	291	-48	Margins fall more than expected – management guides to pulling them back to 275-280bps over the year, but will be back-ended: a disappointment
Fee Inc/Operating Income	23.5	26.8	-338	23.8	-31	
Other Non-Interest Inc/Op Inc	36.9	32.7	420	36.7	13	
Op. Cost/ Operating Income	47.1	49.0	-196	43.9	318	
Loan-to-Deposit Ratio (LDR)	71.8	71.8	4	74.8	-300	Over 20% of book is offshore, and has been growing more rapidly than the domestic book
NPL/Loan Ratio	1.4	1.9	-43	1.3	17	Restructured assets rise from 1.8% of loans to 2.5% – but within previously indicated levels, and this portfolio appears to be facing relatively little pain
LLR/NPL Ratio	82	72	922	76	618	Coverage ratio at a high – reflecting profit cushion in current quarter

Source: Company Reports, Citi Investment Research and Analysis Estimates

Bank of Baroda

Company description

Bank of Baroda (BOB) was incorporated in 1908 as a private institution, and subsequently nationalized in 1969. The bank is headquartered in Baroda, Gujarat. The government holds 53.8% of the bank's equity. BOB is among the top-five banks in the country, with a nearly 4% share of the deposits and advances of the banking system. BOB has a large nationwide branch network of 2,926 branches, and has 74 branches in 25 countries.

Investment strategy

We rate BOB Hold/Medium Risk (2M). It has made visible improvements in key operating parameters and has shown consistent growth and profitability over the last 18 months. Loan growth, which historically lagged the industry, has been above 25%, margins have sustained at near 3%, and asset quality has continued to improve. Its technology plan has been slow to take off, but is now in place and with its aggressive restructuring and marketing initiative over the last year it is the only large government bank with such a track record. Structurally, we believe BOB will continue to trade at a discount to its larger peers due to its lower fee income, higher proportion of international businesses, modest lending franchise, and slight geographic concentration. BOB is likely to remain one of the most interest-rate cyclical banks among its larger peers. While BOB's fundamentals remain healthy, we view that this appears to be priced in current valuations.

Valuation

Our target price of Rs495 is based on CIRA's EVA model, which we believe captures the long-term value of the business and is a standard valuation measure for the CIRA India banking coverage. Our target price assumes: a) risk-free rate of 6.5% (in line with our assumptions for other Indian banks); b) long-term loan loss provisions of 110bps; c) loan spreads of 210bps in-line with industry levels; and d) long-term fee income growth of 9%. We benchmark our target price on a 1.25x 1-yr forward (FY10E) PBV. Our fair value based on this methodology is Rs496. Our target multiple factors in a higher risk appetite (reducing the market risk premium) and reduced pressure on asset quality. Our target multiple continues to be at a 10% discount to those for SBI and PNB. We believe a valuation discount to some peer banks is still justified due to the quality and structure of the businesses.

Risks

We rate BOB Medium Risk based on our quantitative risk-rating system, which tracks 260-day share price volatility. The following downside risks could impede the stock from reaching our target price: (1) Sharp rises in interest rates, which could undermine the performance of the bond portfolio; (2) BOB's inability to sustain loan growth; and (3) Sharp rise in asset deterioration. Key upside risks for the stock include: (1) Improvement in its funding franchise leading to an increase in NIMs; (2) Lower than expected asset quality deterioration and loan loss charges; and (3) Improvement in fee income growth and return profile.

Appendix A-1

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Bank of Baroda (BOB.BO) Ratings and Target Price History Fundamental Research

Analyst: Aditya Narain, CFA

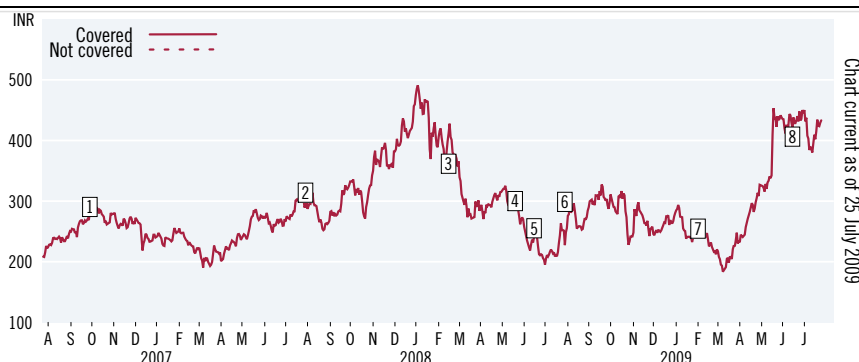


Chart current as of 25 July 2009

	Date	Rating	Target Price	Closing Price
1	28-Sep-06	1M	*326.00	286.60
2	30-Jul-07	1M	*390.00	293.15
3	15-Feb-08	1M	*475.00	411.85

	Date	Rating	Target Price	Closing Price
4	20-May-08	1M	*380.00	291.90
5	16-Jun-08	1M	*300.00	241.05
6	29-Jul-08	1M	*285.00	227.35

	Date	Rating	Target Price	Closing Price
7	1-Feb-09	1M	*315.00	252.55
8	14-Jun-09	*2M	*495.00	429.60

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2009

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